IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 467.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

SYLVIE R. GRIFFITHS,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT.

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Opinions Below.

The memorandum opinion of the Board of Tax Appeals (R. 8-9) is unreported. The *per curiam* opinion of the Circuit Court of Appeals for the Second Circuit (R. 14) is reported in 129 F. (2d) 321.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered July 20, 1942 (R. 14). The petition for writ of certiorari was filed October 20, 1942, and was granted November 23, 1942 (R. 15). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

I.

Was a stock dividend of common shares upon common shares, where there was no other class of stock outstanding, taxable as income under the Internal Revenue Code and Treasury Regulations in effect during the year 1939?

II.

Does such a stock dividend constitute income within the meaning of the Sixteenth Amendment?

III.

Was the retroactive amendment of Section 19.115-7 of Treasury Regulations 103, valid?

Constitutional Provisions, Statutes and Regulations Involved.

The provisions of the Constitution, Statutes and Treasury Regulations involved are set forth in the Appendix (*infra*, p. 25).

Statement.

This case involves an alleged deficiency in income tax for the year 1939 asserted against Sylvie R. Griffiths, the respondent in this Court.

The more important facts are summarized in the opinion of the Board of Tax Appeals (R. 8-9):

> "This proceeding assails a determination of a deficiency of $9.60 in petitioner's income tax for 1939.

It is submitted upon the pleadings under Rule 30. The facts alleged in the petition are all admitted in the answer.

"The Commissioner determined that stock dividends of common shares received by the petitioner in the taxable year upon shares which she owned of exactly the same class and kind, there being no other or different stock outstanding, were income to the extent of their value.

"The determination is reversed."

The Board's decision that there was no deficiency in income tax (R. 9) was affirmed *per curiam* by the court below (R. 14).

The facts alleged by the taxpayer in her petition to the Board (R. 1-7) and admitted by the Commissioner in his answer (R. 8) are as follows:

"Standard Oil Company (New Jersey) is a corporation organized and existing under the laws of the State of New Jersey. Throughout the year 1939 its total authorized capital stock was $750,000,000 divided into 30,000,000 shares of the par value of $25 each, of which there were issued and outstanding on January 1, 1939, approximately 26,500,000 shares of the aggregate par value of approximately $662,500,000. In addition, the corporation had on January 1, 1939, a capital surplus per books of approximately $66,500,000 and earned surplus and undivided profits per books of approximately $130,000,000. The amounts represented by said outstanding capital stock, capital surplus, earned surplus, and undivided profits were invested in assets or otherwise used by the corporation for the purposes of its business.

"All of the shares of the capital stock of said corporation which were outstanding at any time during the year 1939 were of the same class and character;

and the rights and interest of the holder of each share thereof were identical with those of the holder of every other share.

"On May 1, 1939, the board of directors of Standard Oil Company (New Jersey) adopted resolutions whereby they directed that on June 15, 1939, there be distributed to the stockholders of record at the close of business on May 16, 1939, additional shares of the capital stock of the corporation on the basis of two (2) shares of such stock for each two hundred (200) shares of the capital stock of the corporation held on said record date, and that for each additional share of the capital stock so issued the earned surplus account be charged with $27.50 and the capital stock account be credited with the par value of such share, namely, $25.00, and the capital surplus account be credited with $2.50. In accordance with these directions, the transfers from the earned surplus account to the capital stock account and the capital surplus account were made, and the new shares of stock were issued against the amount transferred to the capital stock account, and these new shares were divided among the stockholders on the date and in the proportions above described. The total amount so transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913.

"On November 1, 1939, the board of directors of Standard Oil Company (New Jersey) adopted resolutions whereby they directed that on December 15, 1939, there be distributed to the stockholders of record at the close of business on November 15, 1939, additional shares of the capital stock of the corporation on the basis of three (3) shares of such stock for each two hundred (200) shares of the capital stock of the corporation held on said record date, and that

for each additional share of the capital stock so issued the earned surplus account be charged with $27.50 and the capital stock account be credited with the par value of such share, namely, $25.00, and the capital surplus account be credited with $2.50. In accordance with these directions, the transfers from the earned surplus account to the capital stock account and the capital surplus account were made, and the new shares of stock were issued against the amount transferred to the capital stock account, and these new shares were divided among the stockholders on the date and in the proportions above described. The total amount so transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913.

"The additional shares of the capital stock of Standard Oil Company (New Jersey) so distributed as stock dividends on June 15, 1939, and December 15, 1939, respectively, were of precisely the same class and character as the shares of the capital stock in respect of which the distributions were made. In each instance, the proportionate interest of each shareholder in the corporation immediately after the issuance and distribution of the new shares was the same as his former interest. In neither instance did any shareholder have a right to an election or option to receive cash or other property in lieu of his proportion of the additional shares of the capital stock issued and distributed.

"On May 16, 1939, and continuously to the time of the distribution of said stock dividend on June 15, 1939, the petitioner was the owner and holder of 101 shares of the capital stock of Standard Oil Company (New Jersey) of which her total adjusted cost basis for computing gain or loss for federal income tax purposes was $5,750.36. On June 15,

1939, she received in respect of said shares, as her proportion of the stock dividend distributed on that date, 1.01 additional shares of the capital stock of that corporation. The fair market value of each share of the capital stock of said corporation on June 15, 1939, immediately after the receipt of said additional shares by the petitioner, was $42.50; and the fair market value at that time of the 102.01 shares then held by the petitioner was $4,335.43, including the fair market value of said 1.01 additional shares which was $42.93.

"The amount transferred by Standard Oil Company (New Jersey) from its earned surplus account to its capital stock account in connection with the issuance of said 1.01 additional shares was $25.25; and the amount transferred from its earned surplus account to its capital surplus account in connection with the issuance of said shares was $2.525.

"From June 15, 1939, to the time of the distribution of the said stock dividend on December 15, 1939, the petitioner was the owner and holder of 102.01 shares of the capital stock of Standard Oil Company (New Jersey). On December 15, 1939, she received in respect of said shares, as her proportion of the stock dividend distributed on that date, 1.53 additional shares of the capital stock of that corporation. The fair market value of each share of the capital stock of said corporation on December 15, 1939, immediately after the receipt of said additional shares by the petitioner was $43.1875; and the fair market value at that time of the 103.54 shares then held by the petitioner was $4,471.63, including the fair market value of said 1.53 additional shares which was $66.08.

"The amount transferred by Standard Oil Company (New Jersey) from its earned surplus account to its capital stock account in connection with the issuance of said 1.53 additional shares was $38.25; and the amount transferred from its earned surplus

account to its capital surplus account in connection with the issuance of said shares was $3.825.

"None of said additional shares of the capital stock of Standard Oil Company (New Jersey) received by the petitioner as stock dividends have been cancelled or redeemed by the corporation. None of said shares were sold by the petitioner during the taxable year here involved.

"In her federal income tax return for 1939, the petitioner did not include in her gross income any amount in respect of the additional shares of the capital stock of Standard Oil Company (New Jersey) which she received as stock dividends on June 15, 1939, and December 15, 1939, respectively.

"At all times here material, the petitioner kept her books of account and made her federal income tax returns in accordance with the cash receipts and disbursements method of accounting and on the calendar year basis."

Argument.

I.

The Internal Revenue Code does not impose income tax upon stock dividends of the type here involved. The Treasury Regulations in force during the taxable year 1939 stated that such stock dividends were not taxable.

The history of the taxation of stock dividends as income, since the adoption of the Sixteenth Amendment, is briefly as follows:

The Revenue Act of 1913 (*infra*, p. 25) did not specifically refer to dividends payable in stock. It levied a tax upon "the entire net income" of every citizen residing at home or abroad and of every person residing in

the United States though not a citizen. It further provided that the net income of a taxable person should include "gains, profits, and income derived from * * * dividends * * *, or gains or profits and income derived from any source whatever * * *."

In *Towne* v. *Eisner*, 245 U. S. 418 (1918), the question arose as to whether the distribution pro rata to stockholders of an additional amount of stock created by the transfer to capital account of surplus profits earned before January 1, 1913, was a taxable dividend. The Court in a unanimous opinion written by Mr. Justice Holmes concluded that the dividend was capital. It quoted, with approval, from *Gibbons* v. *Mahon*, 136 U. S. 549, 559, 560:

> "A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished, and their interests are not increased. * * * The proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of new ones."

In the Revenue Act of 1916 (*infra*, pp. 25-26) Congress attempted to tax stock dividends specifically, and provided that the term "dividends" should be held to mean any distribution made by a corporation out of its earnings or profits accrued since March 1, 1913, and payable to its shareholders "whether in cash or in stock of the corporation" and that a stock dividend should be "considered income, to the amount of its cash value".

Eisner v. *Macomber*, 252 U. S. 189 (1920), involved the question of whether these provisions of the 1916 Act were applicable to the fifty per cent. stock dividend declared by the Standard Oil Company of California in January 1916.

The majority opinion of the Court held that such a stock dividend was not income and said in part (p. 207):

> "Here we have the essential matter: *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in*, being '*derived*', that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description."

In the Revenue Act of 1921, Sec. 201 (d) (*infra*, p. 26) Congress accepted the principle that a stock dividend was not income and provided specifically, "a stock dividend shall not be subject to tax * * *."

A consideration of this and other provisions of the Revenue Act of 1921 shows that this acceptance of the nontaxability of stock dividends was not merely an acquiescence by Congress in the decision of *Eisner* v. *Macomber*, but part of a plan to distinguish, and tax on different bases, recurring income from gains or profits derived from the sale or other disposition of capital assets. In the earlier revenue acts capital gains had been treated as fully taxable. This resulted in taxing in a single year profits that had accrued over a period and interfered with normal economic transactions. Stockholders were unwilling to dispose of their securities or even to vote in favor of corporate reorganizations for fear that a taxable gain might be realized. As the result, an entirely new approach to the taxation of capital profits was incorporated in the Revenue Act of 1921. Gains and losses from the sale or other disposition of capital assets were segregated from ordinary income and were taxed at different rates (Sec. 206 (b), *infra*, p. 26). Congress went further and defined four types of transactions in which gain or loss would not

be recognized for tax purposes (Sec. 202 (c) *infra*, p. 26). These were: (1) an exchange of property held for investment or productive use in trade or business for property of a like kind or use; (2) an exchange of stock or securities for stock or securities in connection with a reorganization; (3) an exchange in which property was transferred to a corporation and the transferror was in control of the corporation immediately after the transfer; and (4) a compulsory or involuntary conversion of property into other property similar or related in service or use to the property so converted. In subsequent revenue acts these provisions were amplified and extended.

The purpose of Congress in making these changes is set forth in the report of the Ways and Means Committee (67 Cong. 1st Sess., H. Rept. 350, p. 10):

> "Under existing law the presumption is in favor of taxation. The proposed bill modifies that presumption by providing that on an exchange of property for property no gain or loss shall be recognized unless the property received in exchange has a definite and readily realizable market value; and specifies in addition certain classes of exchanges on which no gain or loss is recognized even if the property received in exchange has a readily realizable market value.
>
> "The preceding amendments, if adopted, will, by removing a source of grave uncertainty, not only permit business to go forward with the readjustments required by existing conditions but will also considerably increase the revenue by preventing taxpayers from taking colorable losses in wash sales and other fictitious exchanges."

The provision of the Revenue Act of 1921, specifically exempting stock dividends was reinacted as part of all revenue acts in force prior to the year 1936 (*infra*, p. 26).

On May 18, 1936, this Court decided *Koshland* v. *Helvering*, 298 U. S. 441, in which it said (p. 445):

> "Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, the Treasury gave the decision a broader interpretation which Congress followed in the Act of 1921."

Thereafter, on June 22, 1936, there was enacted the Revenue Act of 1936, which provided:

> "115 (f) Stock Dividends—
>
> "(1) *General Rule.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution."

It will be observed that this provision is worded in the negative and clearly contemplates that some stock dividends do not constitute income. The petitioner contends that this phraseology was adopted only out of respect for this Court and that the true intent of Congress was to tax all stock dividends to the limit of its constitutional power. This construction renders meaningless various other provisions of the statute (see Sec. 115 (f) (2), *infra*, p. 30; Sec. 115 (h) (2), *infra*, p. 30; and Sec. 115 (j), *infra*, p. 30). Petitioner's argument does violence to the well established principle of statutory construction that effect must be given, if possible, to every provision of the law.

The true purpose of the statute is shown by the discussion had in the House of Representatives at the time the bill was pending (Cong. Rec., Vol. 80, pp. 6214-15, 6309, 6310). Mr. Doughton, Chairman of the Ways and Means Committee introduced the bill and in the course of the

debate left to Mr. Vinson of Kentucky, a member of the Committee, the explanation of various detailed provisions:[1]

(pp. 6214-15)

"Mr. Vinson of Kentucky. * * * Coming now to stock dividends, this is a field that has more or less been surrounded with mystery. Existing law provides that no tax shall be levied upon stock dividends. We strike that from this bill. There are innumerable types of stock dividends that are taxable under the Constitution and under the celebrated case of Eisner versus Macomber.

"The kind of securities issued and the change in the proportion of ownership of a person in a corporation are the determining factors as to whether or not it is taxable income under the sixteenth amendment. * * *

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1 In *Wright* v. *Vinton Branch*, 300 U. S. 440 (1937), the Court in an opinion delivered by Mr. Justice Brandeis said (p. 463):

"Since the language of the Act is not free from doubt in the particulars mentioned, we are justified in seeking enlightenment from reports of Congressional committees and explanations given on the floor of the Senate and House by those in charge of the measure."

In support of this statement the Court inserted a footnote, reading as follows:

"Where the meaning of legislation is doubtful or obscure, resort may be had in its interpretation to reports of Congressional committees which have considered the measure. (*McLean* v. *United States*, 226 U. S. 374, 380; *Tagg Bros. & Moorhead* v. *United States*, 280 U. S. 420, 435); to exposition of the bill on the floor of Congress by those in charge of or sponsoring the legislation, (*Duplex Printing Press Co.* v. *Deering*, 254 U. S. 443, 475; *Richbourg Motor Co.* v. *United States*, 281 U. S. 528, 536); to comparison of successive drafts or amendments of the measure, (*United States* v. *Pflisch*, 256 U. S. 547, 551; *United States* v. *Great Northern Ry. Co.*, 287 U. S. 144, 155); and to the debates in general in order to show common agreement on purpose as distinguished from interpretation of particular phraseology. (*Federal Trade Comm'n* v. *Raladam Co.*, 283 U. S. 643, 650; *Humphrey's Executor* v. *United States*, 295 U. S. 602, 625)."

"It is our purpose to allow as a dividend credit distribution in stock of corporations, or in rights to acquire stock of a corporation which constitutes income to the shareholder within the meaning of the sixteenth amendment. In no sense is this an attack upon the Eisner against Macomber decision. * * *

"With permission of the chairman, I insert herewith memorandum furnished me by Mr. Kent, Acting General Counsel of the Bureau of Internal Revenue:

'Reference is made to the request of Representative Vinson for a compilation of cases involving the taxability as income of stock dividends.

In the following cases the stock dividends or rights received were considered a mere change of form and not the realization of income and, therefore, were not taxable.

Towne v. *Eisner* (245 U. S. 418);
Eisner v. *Macomber* (252 U. S. 189);
Miles v. *Safe Deposit & Trust Co. of Baltimore* (259 U. S. 247, aff'g 273 Fed. 822);
United States v. *Mellon* (279 Fed. 91, aff'd 281 Fed. 645);
United States v. *Davison* (1 Fed. (2d) 465, aff'd 9 Fed. (2d) 1022, cert. den. 271 U. S. 670);
Michaels v. *McLaughlin* (80 Fed. (2d) 959);
Teehan v. *West* (25 Fed. (2d) 884);
Irving v. *United States* (44 Fed. (2d) 246);
Jackson v. *Commissioner* (51 Fed. (2d) 650);
Pearl B. Brown v. *Commissioner* (69 Fed. (2d) 602, aff'g 26 B. T. A. 901, cert. den. 293 U. S. 570);
Frances. E. Clark (77 Fed. (2d) 89, aff'g 28 B. T. A. 1225);
Commissioner v. *Kashland* (81 Fed. (2d) 641, cert. granted 56 Sup. Ct. 669);
Theresa Zellerbach et al. (2 B. T. A. 1076);

W. Q. Wright v. *Commissioner* (10 B. T. A. 806);
George T. Smith v. *Commissioner* (21 B. T. A. 782);
T. I. Hare Powel v. *Commissioner* (27 B. T. A. 55).

In the following cases the dividends received were distinguished from stock dividends and could, therefore, be treated as realized, taxable income.

Peabody v. *Eisner* (247 U. S. 347) (dividend of preferred and common stock of a different corporation).

Doerschuck v. *United States* (274 U. S. 739) (dividend of debenture bonds of the same corporation).

Vogt Machine Co. v. *United States* (39 Fed. (2d) 986, certiorari denied, 282 U. S. 861). (Company declared cash dividend, bearing interest at 4 percent. to be paid 6 and 12 months thereafter in stock to be issued.)

United States v. *Fuller* (42 Fed. (2d) 471). (Dividend of the corporation's own bonds.)

Tillotson Manufacturing Co. v. *Commissioner* (76 Fed. (2d) 189, affirming 27 B. T. A. 913). (Accrued dividends on preferred stock paid in common stock of the corporation, some preferred-stock holders, however, accepting cash instead.)

Eugene E. Paul et al. v. *Commissioner* (2 B. T. A. 150). (Cash dividend declared. Six days later new stock issue was authorized, and stockholders agreed that dividend checks would be used to purchase the newly issued common and preferred stock.)

W. J. Hunt v. *Commissioner* (5 B. T. A. 356). (Prior to declaration of cash dividends, stockholders agreed among themselves to apply checks toward purchase of previously issued stock.)

Luthe Hardware Co. v. *Commissioner* (6 B. T. A. 53). (Cash dividend declared, but holders of 294

out of 300 shares held checks until new stock was issued and then endorsed checks over for purchase of new shares.)

J. E. Brading v. *Commissioner* (17 B. T. A. 429). (New stock issued to stockholders of close corporation after passage of resolution that debt thus incurred was to be liquidated by application of dividends due, or to become due, or as the board of directors might direct. A dividend was then declared and applied toward payment of the price of the new stock.)

Margaret B. Payne v. *Commissioner* (19 B. T. A. 1305). (Cash dividend was declared, and checks were issued, but, in accordance with previous agreement among stockholders that this dividend was to be treated as a stock dividend, the stockholders used it to purchase a new issue of stock.)

Joseph Paper v. *Commissioner* (29 B. T. A. 523). (Resolution gave stockholders option to take dividends in cash or in preferred stock.)

L. Elmer Wood et al. v. *Commissioner* (29 B. T. A. 731). (Resolution provided that accrued dividends on 6-percent preferred stock should be paid from net earnings, but preferred-stockholders were given opportunity to use dividends for purchase of entire new issue of 7-percent preferred.)

• • • • • • • •

(p. 6309)

"Mr. Vinson of Kentucky. • • • The proposed plan does not change the law and does not in the slightest degree strike at the decision of the Supreme Court in the case of Eisner and Macomber in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder."

• • • • • • • •

(p. 6310)

"Mr. Treadway. • • • I understand the gentleman's explanation to be that the language of the act was too broad. I do not mean too broad in the sense it is not legal, but it goes further than the Eisner against Macomber decision.

"Mr. Vinson of Kentucky. That is correct."

The Treasury Department adopted this construction in promulgating Regulations 94 relating to the 1936 Act. In Article 115-7 (*infra*, pp. 31-33) it stated:

"A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old."

It then inserted in the regulation three examples to illustrate the application of the tax to different types of stock dividends. The second example involved a case on all fours with the case at bar, that is a dividend in common stock distributed *pro rata* to common shareholders, there being only one class of authorized stock. This example concluded with the statement (*infra*, p. 33):

"The stock so distributed does not constitute a taxable stock dividend to the shareholders."

In 1938, while the foregoing Regulations were in force and such construction was being applied, Congress reenacted the provisions of Section 115 (f) of the 1936 Act, without change, as Section 115 (f) of the Revenue Act of 1938. The Treasury Department then promulgated Regulations 101, relating to the new act, and included, as Article 115-7, the precise provisions of the corresponding article of Regulations 94. In 1939, the provisions of Section 115 (f) of the Revenue Acts of 1936 and 1938

were adopted as Section 115 (f) of the Internal Revenue Code; and the Treasury Department then repromulgated the provisions of Article 115-7 of Regulations 94 and 101 as Section 19.115-7 of Regulations 103.

This regulation relating to the Internal Revenue Code, which governs the present case, continued in full force and effect until November 15, 1940, when it was amended so as to delete the statements above mentioned. (T. D. 5020, *infra*, p. 33). The amendment was made more than one year after the stock dividends here involved had been declared, and eight months after the respondent's tax return was filed.

It is now asserted that Congress by amending the Revenue Act of 1936 attempted to tax stock dividends to the full extent permitted by the Constitution. We submit that the legislative history shows that Congress had no such intention. On the contrary, Congress acquiesced in the holding of *Eisner* v. *Macomber* that a true stock dividend, that is, a dividend where additional shares of common stock are created by a transfer of surplus to capital account and are distributed *pro rata* to common stockholders, did not represent income. By the amendment Congress attempted to tax only those dividends paid in stock which resulted in changing the proportionate interests of the shareholders. The statements made in the course of the debate on the bill in Congress, quoted above, coupled with the Treasury Regulations which were published contemporaneously, show beyond peradventure of a doubt that Congress did not intend to tax a true stock dividend.

A final proof lies in the fact that Standard Oil Company of New Jersey on December 15, 1938, distributed a stock dividend comparable in every respect to those involved in the case at bar, and the Treasury Depart-

ment issued a special ruling in a letter addressed to the corporation dated December 29, 1938, which read in part (1939 C. C. H. Federal Tax Service, Vol. 3, par. 6072):

> "Since you had but one class of authorized stock, the distribution of additional shares to your stockholders did not result in the receipt by them of income within the meaning of the Sixteenth Amendment to the Constitution; *Eisner* v. *Macomber*, 252 U. S. 189, Treasury Decision 3010, 3 C. B. 25 (1920)."

This ruling was issued by the Treasury Department after the enactment of the Revenue Act of 1938 in respect of a stock dividend that was taxable under that Act which, so far as material, is identical with the applicable statute in the present case.

II.

Eisner v. _Macomber_ is directly in point and was correctly decided. No valid reason has been suggested for overruling it and the many other cases decided on its authority.

The petition for the writ of certiorari herein states that this proceeding is a test case designed to challenge directly the authority of *Eisner* v. *Macomber*, *supra*. For the reasons pointed out above we do not believe that the Internal Revenue Code taxed a true stock dividend as income. Nevertheless, if this Court should conclude otherwise and undertake to reexamine the *Macomber* case we believe it will find that it was correctly decided.

The issue in the *Macomber* case was whether a true stock dividend represented income and was therefore a proper subject of taxation under the Sixteenth

Amendment. There is no need to repeat the elaborate arguments considered and disposed of in that case. They are too well known to require elaboration. The *ratio decidendi* of the majority of the Court has already been quoted (p. 9, *supra*) and is based on the sound principle that "income" cannot include a mere change of form that does not add in any respect to the rights or privileges of the stockholder and does not in any way change his proportionate interest in the corporate enterprise.

The *Macomber* case has been the controlling authority in regard to the taxability of stock dividends for more than twenty-two years. It has been cited with approval in numerous cases. It has been distinguished in cases involving reorganizations[2] and distributions which were not true stock dividends[3], but its basic proposition that a true stock dividend does not constitute "income" has been uniformly upheld. Also on its authority depends the whole line of cases holding that the distribution of rights to subscribe to securities of the issuing corporation do not constitute income[4]. If *Eisner* v. *Macomber* is overruled these cases also must fall.

The petition for the writ of certiorari called attention to the fact that two other cases involving the taxability of stock dividends are now pending before this Court (*Helvering* v. *Sprouse*, No. 22, Present Term, and *Strassburger* v. *Helvering*, No. 66, Present Term). The brief in the latter case asserts (pp. 22, 29) that the effect

2 See *United States* v. *Phellis*, 257 U. S. 156 (1921); *Rockefeller* v. *United States*, 257 U. S. 176 (1921); *Cullinan* v. *Walker*, 262 U. S. 134 (1923); and *Marr* v. *United States*, 268 U. S. 536 (1925). But note, however, the provisions of the Revenue Act of 1921 making exchanges in connection with reorganizations non-taxable transactions.

3 See *Koshland* v. *Helvering*, 298 U. S. 441 (1936); *Helvering* v. *Gowran*, 302 U. S. 238 (1937); and *Helvering* v. *Pfeiffer*, 302 U. S. 247 (1937).

4 See *Miles* v. *Safe Deposit Co.*, 259 U. S. 247 (1922) and *Palmer* v. *Commissioner*, 302 U. S. 63 (1937).

of the adoption of the Sixteenth Amendment was to reverse the decision of this Court in *Pollock* v. *Farmers' Loan and Trust Company*, 157 U. S. 429, 158 U. S. 601. On the assumption that the *Pollock* case is no longer law, it suggests that this Court might conclude that Article I of the Constitution granted Congress an unlimited power of taxation, subject only to the requirements of uniformity in respect of duties, imposts and excises and of apportionment among the several states in the case of capitation and taxes on real estate (p. 18). The conclusion is irresistible that the petitioner hopes to review in this proceeding the whole line of authority governing the taxing power of the Federal government.

These issues are irrelevant. The case at bar involves only the question of whether the Internal Revenue Code taxes true stock dividends as income and whether a true stock dividend is income within the meaning of the Sixteenth Amendment.

The *Pollock* case was not reversed by the adoption of the Sixteenth Amendment. It was, in fact, affirmed because Congress accepted the conclusion of this Court that a tax on the income of property was a direct tax within the meaning of the Constitution and therefore subject to apportionment, and proposed an amendment designed to give the Federal government a limited power to impose "taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration".

The brief in the *Strassburger* case also refers (pp. 22, 28) to the Civil War income tax acts and states that stock dividends were then subjected to tax and that even the earnings and profits of corporations were taxed to shareholders, irrespective of whether they had been distributed. These issues are likewise irrelevant, but we respectfully call the attention of the Court to the fact that the Civil War in-

come tax laws did not have the effect that these brief statements would seem to imply. The income tax law of 1864 (c. 173, 13 Stat. 281, 283, 284) imposed in effect two different types of taxes. In the case of banks, trust companies, savings institutions and fire, marine, life, and inland insurance companies, and also in the case of railroads and canal, turnpike, canal navigation and slack water companies, a tax was imposed upon the company and was measured by a percentage of certain types of interest and all dividends in scrip or money paid to stockholders, policyholders or depositors as part of the earnings, and by a like percentage of any undistributed sums added to surplus and other accounts. These taxes were payable by the corporation, and the income distributed to the individual taxpayers was excluded in computing their incomes. In the case of all other corporations and in the case of partnerships, the earnings were taxed directly to the shareholders or partners even if not distributed. It is not difficult to find the reason for this differentiation. The companies subjected to tax were those requiring large capital and which were apt to have a large number of shareholders. The companies exempted from tax were principally private enterprises which in many instances had originally been partnerships. In effect, therefore, the Civil War income tax statutes were analogous to the revenue acts passed after the enactment of the Sixteenth Amendment in that Congress adopted a reasonable classification and in some instances imposed an income tax liability on an organization as an entity, and in others disregarded the legal entity and taxed the beneficial interest directly to the owner.

Without attempting to catalogue all the cases in which the revenue acts have disregarded a legal entity or taxed as an entity organizations that had no separate legal existence, it will, we believe, be sufficient to point out that

unincorporated associations and trusts that are analogous to corporations in their organization have been taxed as corporations, and estates in process of administration and testamentary and *inter vivos* trusts have been taxed as individual taxpayers. On the other hand, the existence of a corporate entity has been disregarded in the case of personal service corporations under the excess-profits tax law of 1917, personal holding companies under some of the later revenue acts, and corporations formed or availed of for the purpose of avoiding the imposition of the surtax. No doubt exists as to the power of Congress to make such reasonable classifications, and we cannot believe that *Eisner* v. *Macomber* has prevented Congress, as the petitioner suggests, from adopting the general principle of taxing to shareholders the undistributed earnings of corporations. There is not the slightest evidence that Congress ever had any such intention.

III.

Treasury Decision 5020, promulgated on November 15, 1940, amending Treasury Regulations 103 is invalid as an attempt to extend retroactively the scope of the Internal Revenue Code.

Section 62 of the Internal Revenue Code (*infra*, p. 27) provides as follows:

> "The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this chapter."

Pursuant to the power thereby granted, the Commissioner of Internal Revenue published Regulations 103 on January 29, 1940. Section 19.115-7 of these Regulations provided specifically that a true stock dividend was not

taxable. On November 15, 1940, by T. D. 5020 (*infra*, p. 33) this section of Regulations 103 was amended by deleting the reference to non-taxable stock dividends and the examples. It is now asserted that as a result of this amendment the stock dividends received by the respondent in 1939 were taxable as income to the extent of their market value when received. We submit that this retroactive amendment is invalid.

The situation is in all respects identical with the facts considered by this Court in *Helvering* v. *Reynolds Co.*, 306 U. S. 110 (1939). In that case, as in the case at bar, Congress reenacted in identical words a provision of a preceding revenue act after the Commissioner had published regulations construing the law. It was held that the subsequent retroactive amendment was invalid, and this court said (p. 116):

> "Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed."

To the same effect see *Rasquin* v. *Humphreys*, 308 U. S. 54, 56 (1939). See also *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90 (1939); *Helvering* v. *Reynolds*, 313 U. S. 428 (1941).

It should be noted also that Section 19.115-7 of Regulations 103, as originally promulgated, was the same as Article 115-7 of Regulations 101 which had been promulgated in respect of the Revenue Act of 1938, and Article 115-7 of Regulations 94 promulgated in respect of the Revenue Act of 1936. The statutory provisions to which these several regulations referred were identical. Regulations 94 were promulgated before Congress reenacted as

part of the Revenue Act of 1938 the precise provision of Section 115 (f) of the Revenue Act of 1936. If the enactment of the Internal Revenue Code in 1939 is to be treated as a new Revenue Act and not merely as a codification of existing law, then the sections here in question were twice reenacted while the applicable Treasury Regulations specifically provided that a true stock dividend was not taxable.

The vice of Treasury Regulations which upset established practices is apparent from the present case. At the time the stock dividends in question were distributed they were specifically exempt from tax. At the time the respondent prepared and filed her income tax return the same situation existed. Nearly one year later, by an amended regulation, the respondent is charged with tax liability. She and all other taxpayers who received stock dividends in 1939 and subsequent years will be subject to the assessment of deficiencies if this amended regulation is upheld, and this Court should, as the petitioner suggests, overrule the *Macomber* case.

CONCLUSION.

The judgment below should be affirmed.

Respectfully submitted,

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APPENDIX.

Constitution of the United States:

Sixteenth Amendment.—The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.

Revenue Act of 1913, c. 16, 38 Stat. 114, 166-167:

Section II.

A. Subdivision 1. That there shall be levied, assessed, collected and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, a tax of 1 per centum per annum upon such income, except as hereinafter provided; and a like tax shall be assessed, levied, collected, and paid annually upon the entire net income from all property owned and of every business, trade or profession carried on in the United States by persons residing elsewhere.

* * * * * * * * *

B. That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from * * * dividends * * *, or gains or profits and income derived from any source whatever * * *.

Revenue Act of 1916, c. 463, 39 Stat. 756:

Income Defined.

Sec. 2. (a) That, subject only to such exemptions and deductions as are hereinafter allowed, the net in-

come of a taxable person shall include gains, profits, and income derived from * * * dividends * * *: *Provided*, That the term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation * * *, which stock dividend shall be considered income, to the amount of its cash value.

Revenue Act of 1921, c. 136, 42 Stat. 227:

Sec. 201. (d) A stock dividend shall not be subject to tax * * *.

[This provision was reenacted as part of all revenue acts in force prior to the year 1936:

R. A. 1924, c. 234, 43 Stat. 253, sec. 201 (f);
R. A. 1926, c. 27, 44 Stat. 9, sec. 201 (f);
R. A. 1928, c. 852, 45 Stat. 791, sec. 115 (f);
R. A. 1932, c. 209, 47 Stat. 169, sec. 115 (f);
R. A. 1934, c. 277, 48 Stat. 680, sec. 115 (f)]

Sec. 202. (c). For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—[Here is set forth a description of the transactions on which no gain or loss is recognized.]

Sec. 206. (b) In the case of any taxpayer (other than a corporation) who for any taxable year derives a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a

tax determined as follows: [Here is prescribed the method of computation and the rate of tax.]

Revenue Act of 1936, c. 690, 49 Stat. 1648:

[The material provisions of the Revenue Act of 1936, except for minor variations not here material, are the same as the corresponding provisions of the Internal Revenue Code, hereinafter set forth.]

Revenue Act of 1938, c. 289, 52 Stat. 447:

[The material provisions of the Revenue Act of 1938, except for minor variations not here material are the same as the corresponding provisions of the Internal Revenue Code, hereinafter set forth.]

Internal Revenue Code, 53 Stat. 1:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * dividends * * *.

* * * * * * * *

(c) *Distributions by corporations.*—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

* * * * * * * *

SEC. 62. RULES AND REGULATIONS.

The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this chapter.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * * * *

(2) *Stock for stock in same corporation.*—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * * * * * *

(g) *Definition of reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means * * * (E) a recapitalization * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—

* * * * * * * * *

(6) *Tax-free exchanges generally.*—If the property was acquired after February 28, 1913, upon an exchange described in section 112 (b) to (e), inclusive the basis * * * shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law

applicable to the year in which the exchange was made. * * *

* * * * * * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

* * * * * * * * *

(d) *Other Distributions from Capital.*—If any distribution made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, * * *.

* * * * * * * * *

(f) *Stock Dividends.*—

(1) *General Rule.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(2) *Election of Shareholders as to Medium of Payment.*—Whenever a distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (1), or (B) in money or any other property (including its stock or in rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (1)), then the distribution shall constitute a taxable dividend in the hands of all shareholders, regardless of the medium in which paid.

. . . . . .

(h) *Effect on earnings and profits of distributions of stock.*—The distribution (whether before January 1, 1939, or on or after such date), to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

. . . . . .

(j) *Valuation of Dividend.*—If the whole or any part of a dividend is paid to a shareholder in any medium

other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

Treasury Regulations 94, relating to the Revenue Act of 1936:

Art. 115-7. [The material provisions of this Article, as originally promulgated and in force prior to amendment in January 1942 by T. D. 5110, *infra*, were the same as the material provisions of Sec. 19.115-7 of Regulations 103, *infra*, prior to its amendment in November, 1940 by T. D. 5020, *infra*.]

Treasury Regulations 101, relating to the Revenue Act of 1938:

Art. 115-7. [The material provisions of this Article, as originally promulgated and in force prior to amendment in January 1942 by T. D. 5110, *infra*, were the same as the material provisions of Sec. 19.115-7 of Regulations 103, *infra*, prior to its amendment in November 1940 by T. D. 5020, *infra*.]

Treasury Regulations 103, relating to the Internal Revenue Code:

Sec. 19.115-7. *Stock dividends.*—[As in effect during the year 1939 and until amended in November 1940 by T. D. 5020, *infra*.]

A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution. The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute in-

come within the meaning of the Constitution.[1] The distinction between a stock dividend which does not, and one which does, constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution is the distinction between a stock dividend which works no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and a stock dividend where there either has been a change of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the shareholder after the distribution is essentially different from his former interest. A stock dividend constitutes income if it gives the shareholder an interest different from that which his former stock holdings represented. A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old.

. . . . . .

Example (2): On July 1, 1938, the Y Corporation had an authorized capital stock consisting of 1,000 shares of common stock, par value $100 a share, of which 500 shares were outstanding. It had earnings and profits of $40,000 accumulated since February 28, 1913, and $5,000 of earnings and profits of the taxable year. On July 1, 1938, the Y Corporation issued and divided among its shareholders 250 additional shares

[1] See *Eisner* v. *Macomber* (252 U. S. 189, T. D. 3010, C. B. 3, 25 (1920)); and *Koshland* v. *Helvering* (298 U. S. 441, Ct. D. 1124, C. B. XV-1, 219 (1936)). Compare *United States* v. *Phellis* (257 U. S. 156, T. D. 3270, C. B. 5, 37 (1921)); *Rockefeller* v. *United States* (257 U. S. 176, T. D. 3271, C. B. 5, 34 (1921)); *Cullinan* v. *Walker* (262 U. S. 134 T. D. 3508, C. B. II-2, 55 (1923)); *Weiss* v. *Stearn* (265 U. S. 242, T. D. 3609, C. B. III-2, 51 (1924)); and *Marr* v. *United States* (268 U. S. 536, T. D. 3755, C. B. IV-2, 116 (1925)).

of its common stock of a total par value of $25,000 and transferred an equivalent amount from surplus account to capital stock account. The stock so distributed does not constitute a taxable stock dividend to the shareholders.

. . . . . .

T. D. 5020, 1940—2 Cum. Bull. 118:

To Collectors of Internal Revenue and Others Concerned:

Section 19.115-7 of Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.] is amended by striking out all the matter appearing after the first sentence thereof.

(This Treasury decision is issued under the authority contained in section 62 of the Internal Revenue Code (53 Stat., 32).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved November 15, 1940.
John L. Sullivan,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register November 19, 1940, 3.27 p. m.)

T. D. 5110, 1942—4 Int. Rev. Bull. 7:

To Collectors of Internal Revenue and Others Concerned:

Article 115-7 of Regulations 94 [section 3.115-7, Title 26, Code of Federal Regulations] and article 115-7 of Regulations 101 [section 19.115-7, Title 26, Code of Federal Regulations, 1939 Sup.] are each amended by strik-

ing out all of the matter appearing after the first sentence thereof.

(This Treasury decision is issued under the authority contained in section 62 of the Revenue Act of 1936 (49 Stat., 1673, 26 U. S. C. Sup. 62) and section 62 of the Revenue Act of 1938 (52 Stat., 480, 26 U. S. C. Sup. 62).)

Guy T. Helvering,
Commissioner of Internal Revenue.

Approved January 19, 1942.

John L. Sullivan,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 20, 1942, 3.58 p. m.)